United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

77-7192

United States Court of Appeals

FOR THE SECOND CIRCUIT

HAROLD AMES,

Plaintiff-Appellant,

—against—

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC. and CHRISTOPHER V. STREIT,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

APPELLEES' BRIEF

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SECOND CIRCUIT

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FOR THE SECOND CIRCUIT

HAROLD AMES,

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MERRILL LYNCH, PIERCE, FENNER & SMITH, INC. and CHRISTOPHER V. STREIT,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

APPELLEES' BRIEF

Statement of the Case

This action, which was commenced on July 13, 1976, is for money damages for losses incurred in commodity futures trading by a customer, Harold Ames, against a registered futures commission merchant, Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch"), and a commodity account executive employed by Merrill Lynch, Christopher V. Streit. In his complaint (7a-13a*), plaintiff alleges a single cause of action for violations of Sec. 4b (7 U.S.C. §6b) and Sec. 4*o* (7 U.S.C. §6*o*) of the Commodity Exchange Act ("Act"), as amended by the Commodity Futures Trading Commission Act of 1974, 7 U.S.C. §1 *et*

* References are to pages in the appendix filed by appellant.

seq., and seeks recovery for losses on copper (Complaint, ¶¶6-20), plywood (Complaint, ¶21), and lumber futures (Complaint, ¶22). In paragraph 5 of the complaint, plaintiff charges defendants with various violations of the Act in conclusory fashion. Although the essence of plaintiff's claim is fraud, he has in many respects failed to comply with F. R. Civ. P. (9)(b) which requires that the circumstances constituting fraud be pleaded with particularity (i.e., Complaint, ¶¶15, 16, 17). Defendants served an answer (14a-17a) in which they alleged essentially a general denial and asserted that the claim must be submitted to arbitration in accordance with a written agreement to arbitrate (Answer, ¶15).

On September 3, 1976, defendants served plaintiff with a motion to dismiss for failure to state the grounds for the District Court's subject matter jurisdiction or, in the alternative, to stay the trial of the action and to compel arbitration pursuant to a commodity account agreement (18a) at a forum (i.e., New York Stock Exchange) other than a contract market on which commodity futures are traded. Plaintiff did not challenge the voluntariness of the commodity account agreement. He opposed arbitration on the grounds that the *Wilko* doctrine (*Wilko* v. *Swan,* 346 U.S. 427 (1953)) precluded it, and that proposed Reg. §180.3 of Part 180 of the General Regulations under the Commodity Exchange Act, 17 C.F.R. Part 180,* rendered the arbitration agreement unenforceable. The motion was submitted in October, 1976; on March 21, 1977, District Judge Charles S. Haight issued a Memorandum Opinion and Order (36a-62a) in which he granted defendants' motion to stay the proceedings and to compel arbitration,

* Set forth at length in the addendum to this brief.

concluding that the *Wilko* doctrine does not preclude arbitration, and that Reg. §180.3, 17 C.F.R. §180.3, which became effective on November 29, 1976, should not be given retroactive effect to invalidate an otherwise enforceable arbitration agreement. District Judge Haight did not specifically rule on the question, but by implication he determined that the three requirements for a motion to compel arbitration, i.e., there exists a written agreement to arbitrate, there are arbitrable claims in the action, and there has been no waiver of arbitration, *Bigge Crane & Rigging Co.* v. *Docutel Corp.*, 371 F. Supp. 240, 243 (E.D.N.Y. 1973), had been satisfied.

The issues presented on this appeal are whether Reg. §180.3 should be given effect retroactively to void a valid pre-dispute arbitration agreement entered into prior to its effective date, and whether the *Wilko* doctrine should be extended to controversies arising under the Commodity Exchange Act.

ARGUMENT

POINT I

Reg. §180.3 should not be applied retroactively to render unenforceable an arbitration agreement, entered into prior to the effective date of this regulation, providing for the submission of disputes to other than contract market settlement procedures.

History of the Adoption of Reg. §180.3

In July, 1975, the Commodity Futures Trading Commission ("CFTC") made public its preliminary views on contract market (exchange) claim and grievance procedures required by Sec. 5a(11) of the Commodity Exchange Act ("Act"), 7 U.S.C. §7a(11). 40 F.R. 29121 (July 10, 1975). In that release, the CFTC announced that it was preparing a rule covering contract market arbitration or other procedures for the settlement of customer claims that may not be covered by Sec. 5a(11). Question 4, 40 F.R. at 29122.

In August, 1975, the CFTC published proposed rules (40 F.R. 34152, August 14, 1975) setting forth the guidelines to be followed by contract markets in establishing the mandated statutory (Sec. 5a(11), 7 U.S.C. §7a(11)) grievance procedures, including a proposed rule (Proposed Reg. §200.3(c), 40 F.R. at 34154) legislating a total ban on predispute submission agreements between a futures commission merchant and a customer. In proposing this prohibition, the CFTC stated it was acting pursuant to the requirements of both Sec. 5a(11), 7 U.S.C. §7a(11), and Sec. 8a(5), 7 U.S.C. §12a(5), of the Act.

In November, 1975, the CFTC published amended proposed rules, redesignated as Part 180, covering arbitration or other dispute settlement procedures. 40 F.R. 54430 (November 24, 1975). In this release, the CFTC announced:

> "The Commission received several comments strongly criticizing [the proposed rule prohibiting pre-dispute agreements.] The principal criticisms expressed in those comments were that the Commission had incorrectly relied on an unrelated Supreme Court case, *Wilko* v. *Swan,* 346 U.S. 427 (1953), an action under the federal securities laws; that the Commission is not empowered to adopt such a requirement under section 5a(11); that the Federal Arbitration Act, 9 U.S.C. Sections 1-14 (1970), precludes such a requirement; and that such a provision would interfere with existing contractual rights. The Commission's action, in the first instance, was not premised on *Wilko* v. *Swan.* The second of these objections overlooks the fact that the Commission's prior proposed rules were not adopted solely pursuant to section 5a(11). The Commission's announcement stated that those prior rules were being proposed pursuant to section 8a of the Commodity Exchange Act, as amended, 7 U.S.C. 12a, as well as under section 5a(11)." 40 F.R. at 54432.
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> * * * * *
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> "The Commission is amending the prior proposed rule to make clear that the proposed rule [proposed Reg. §180.3(b)] does not apply to claims or grievances which may arise before adoption of the proposed rule. However, existing contracts would be null and void one year after the effective date of the proposed rule, except as to claims and grievances arising before and during the one year period. The amended proposed rule would also expressly prohibit new agreements with such provisions after the effective date of the proposed rule." 40 F.R. at 54433.

Proposed Reg. §180.3(b) provided that the prohibition against pre-dispute submission agreements:—

> "shall not apply to claims or grievances arising out of transactions occurring prior to the date of the adoption of this Part [180] and for a period of one year thereafter if and only if such transactions were subject to agreements actually entered into prior to the date of the adoption of this Part." 40 F.R. at 54435.

Thus, more than a year prior to the effective date of Reg. §180.3, the CFTC, recognizing the extraordinary nature of its regulations, vacillated, and amended the proposed rule so that it would apply prospectively with respect to certain agreements and controversies, in order to afford affected persons time to bring their practices and agreements into conformity with the new standards.

The debate continued. In February, 1976, the CFTC announced it wanted more testimony on the proposed Part 180, in particular, the controversial Reg. §180.3, at a public hearing. 41 F.R. 6120 (February 11, 1976).

Then, in July, 1976, the CFTC published revised Part 180 of the proposed regulations covering arbitration or other dispute settlement procedures. 41 F.R. 27520 (July 2, 1976). All provisions except proposed Reg. §180.3 were to be made effective 90 days from the date of publication of the announcement. Proposed Reg. §180.3 was amended substantially and republished for additional public comments. 41 F.R. 27526 (July 2, 1976). In its revised form, proposed Reg. §180.3 omitted the provision that would have delayed its effective date for certain

existing pre-dispute submission agreements. The CFTC announced:

> "On the effective date [60 days after notice of adoption is published], all compulsory agreements which do not comply with the amended proposed rule §180.3 will be null and void, including those heretofore signed by customers." 41 F.R. at 27527-8.

In September, 1976, the CFTC published proposed Reg. §180.3 substantially in its present form, making it effective 60 days thereafter, on November 29, 1976. 41 F.R. 42942 (September 29, 1976). In this release, the CFTC stated it had responded to a variety of comments and objections and extended an invitation for additional written comments and suggestions. 41 F.R. at 42947. The CFTC also postponed the effective date of all Part 180 regulations to November 29, 1976. *Id.*

In summary, the CFTC first proposed, in August, 1975, to outlaw all pre-dispute submission agreements. 40 F.R. at 34154 (August 14, 1975). In November, 1975, the CFTC backed off this position somewhat, relaxing the ban against pre-dispute arbitration agreements; certain submission agreements would have remained effective. Proposed Reg. §180.3(b); 40 F.R. at 54435 (November 24, 1975). In July, 1976, the CFTC reinstated the total ban against pre-dispute submission agreements if they did not comply with the form and language requirements of proposed Reg. §180.3(b). 41 F.R. at 27527-8 (July 2, 1976). After receiving considerable testimony over an extended period of time, the revised Part 180 regulations were made effective on November 29, 1976.

Retroactive Application of Administrative Agency Rules

The Administrative Procedure Act contains specific provisions governing agency rule making which it defines as "an agency statement of general or particular applicability and future effect." 5 U.S.C. §551(4).

SEC v. *Chenery Corp.*, 332 U.S. 194 (1947) was a case involving the power of the Securities and Exchange Commission to approve the reorganization of a public utility holding company if it found the reorganization would be "fair and equitable to the persons affected thereby." The SEC had disapproved a plan that in its judgment did not meet this test in an order made in the absence of a general rule or regulation covering the matter. The Supreme Court held that the SEC could utilize the individual, *ad hoc* litigation process to announce and apply a new standard of conduct in an order which would not necessarily be invalid because of its retroactive effect.

> "[S]uch retroactivity must be balanced against the mischief of producing a result which is contrary to a statutory design or to legal and equitable principles. If that mischief is greater than the ill effect of the retroactive application of a new standard, it is not the type of retroactivity which is condemned by law." 332 U.S. at 203.

The Supreme Court rather pointedly hinted in *Chenery* that new law developed through the exercise of an administrative agency's rule making power must be given prospective application only. "[T]he function of filling in the interstices of the Act should be performed, as much as possible, through [the] quasi-legislative promulgation of rules to be applied in the future." 332 U.S. at 202.

"[T]he Chenery cases illustrate how Congress may, for the purpose of effectuating a delegation of authority to implement broad statutory standards, provide an administrative agency with a choice of either the general regulation or particular order approach, or a combination of both. Whichever method the agency chooses, the same fundamental elements of administrative discretion are present, and the same fundamental standards of judicial review must be applied—whether the agency has acted within the scope of the delegation and whether there was a rational basis for the exercise of its judgment. Similarly when the agency is authorized to act only by individual order, whether it be an exemption order, as in Grey v. Powell, [314 U.S. 402] or a cease-and-desist order under the Federal Trade Commission Act, the same area of discretion may be present and the same general standard of judicial review be applicable. This is not to say—as indeed the Chenery case well illustrates—that exactly the same factors press equally for consideration no matter which method is involved. Individual orders may be particularly susceptible to attack, either because they come without previous warning, or because they are inconsistent with other orders in comparable situations. General regulations on the other hand may be vulnerable to the charge that they are too rigid and do not allow enough play for significant individual differences. But these are exactly the considerations which the Court must evaluate whenever it has to apply the rational-basis rule—trying as best it can to avoid both usurpation of administrative authority and abnegation of judicial responsibility." N.L. Nathanson, Administrative Discretion in the Interpretation of Statutes, 3 Vand. L. Rev. 470, 489-490 (1950).

In *Greene* v. *U. S.*, 376 U.S. 149 (1964), the Supreme Court denied retroactive effect to a 1960 Defense Depart-

ment regulation governing the payment of wage claims, the claim having matured prior to the issuance of the regulation. Mr. Justice Goldberg, delivering the opinion of the Court, stated:

> "As the Court said in *Union Pac. R. Co.* v. *Laramie Stock Yards Co.*, 231 U. S. 190, 199, 'the first rule of construction is that legislation must be considered as addressed to the future, not to the past . . . [and] a retrospective operation will not be given to a statute which interferes with antecedent rights . . . unless such be "the unequivocal and inflexible import of the terms, and the manifest intention of the legislature."' Since regulations of the type involved in this case are to be viewed as if they were statutes, this 'first rule' of statutory construction appropriately applies and under the circumstances, it would be unjustifiable to give the 1960 regulation retroactive effect." 376 U.S. at 160.

Guidance as to whether an agency rule is to be accorded retroactive effect is found in cases involving the National Labor Relations Board which over the years has effected changes in policy through adjudication rather than rule making. In *NLRB* v. *Majestic Weaving Co.*, 355 F.2d 854 (2d Cir. 1966), a case involving an order of particular application fashioned in an adjudicatory proceeding, Circuit Judge Friendly, referring to and distinguishing *NLRB* v. *A. P. W. Prods. Co.*, 316 F.2d 899 (2d Cir. 1963), *NLRB* v. *Pease Oil Co.*, 279 F.2d 135 (2d Cir. 1960) and *Leedom* v. *Int'l Brotherhood of Electrical Workers*, 278 F.2d 237 (D.C. Cir. 1960), stated:

> "It must be recognized that 'every case of first impression has a retroactive effect, whether the new principle is announced by a court or by an administrative agency,' and that, generally speaking, 'the choice made

between proceeding by general rule or by individual, *ad hoc* litigation is one that lies primarily in the informed discretion of the administrative agency,' SEC v. Chenery Corp., 332 U.S. at 203. But the problem of retroactive application has a somewhat different aspect in cases not of first but of second impression, where an agency alters an established rule defining permissible conduct which has been generally recognized and relied on throughout the industry that it regulates. As a result of the nature of the task Congress has confided to the agencies and the vagueness of the direction it has given, they are, and ought to be, much likelier to engage both in new departures and in alteration than courts with their more limited 'molecular motions,' Southern Pac. Co. v. Jensen, 244 U.S. 205, 221 (1917) (dissenting opinion of Mr. Justice Holmes); and this makes it peculiarly important for them to take full advantage of their power to act prospectively, whether by rule making or adjudication. In this case, we might well conclude that where for fifteen years the Board considered conditional negotiation consistent with the statutory design 'the ill effect of the retroactive application of a new standard' so far outweighs any demonstrated need for immediate application to past conduct, SEC v. Chenery Corp., 332 U.S. at 203, as to render the action 'arbitrary' [5 U.S.C. §706.]" 355 F.2d at 860.

In *Retail, Wholesale & Dep't Store Union* v. *NLRB*, 466 F.2d 380 (D.C. Cir. 1972), a case involving the retroactive application of an order, Circuit Judge McGowan stated:

"Among the considerations that enter into a resolution of the problem [of retroactive application] are (1) whether the particular case is one of first impression, (2) whether the new rule represents an abrupt

> departure from well established practice or merely attempts to fill a void in an unsettled area of law, (3) the extent to which the party against whom the new rule is applied relied on the former rule, (4) the degree of the burden which a retroactive order imposes on a party, and (5) the statutory interest in applying a new rule despite the reliance of a part on the old standard." *Id.* at 390.
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> "Unless the burden of imposing the new standard [retroactively] is *de minimis*, or the newly discovered statutory design compels its retroactive application, the principles which underlie the very notion of an ordered society, in which authoritatively established rules of conduct may fairly be relied upon, must preclude its retroactive effect. . . . " *Id.* at 392.

An administrative agency's choice between giving its rules immediate effect through a particular order made in adjudication, or applying a general regulation prospectively by initiating a separate rule making proceeding is one that lies in the informed discretion of the administrative agency. *SEC* v. *Chenery Corp., supra* at 203. When an agency makes a statement of far-reaching policy to fit all future cases, only the rule making process serves the vital functions of notice to persons who may be affected and an opportunity to be heard. 5 U.S.C. §553. But an administrative agency usually does not enact a rule of general applicability unless it has "had sufficient experience with a particular problem to warrant rigidifying its tentative judgment into a hard and fast rule." *SEC* v. *Chenery Corp., supra* at 202. The CFTC chose to adopt Reg. §180.3 pursuant to its rule making powers, not only because it was about to change long established industry customs and practices, but also because it was legislating an abrupt de-

parture from Congressional policy favoring arbitration irrespective of the form and language of an arbitration agreement or when it was entered into. By its nature, an administrative agency rule can be given prospective application only. 5 U.S.C. 551(4). To allow Reg. §180.3 to be applied retroactively to invalidate arbitration agreements that, but for the regulation, would otherwise be valid and binding on the parties, in the absence of a specific statutory interest in such a rule, will produce a result that is contrary to Congressional policy favoring arbitration and to established legal principles that have been relied upon for many years. As Professor Davis has stated in his treatise: "Because retroactivity is not favored, a reasonable initial view is that retroactive rules should be tolerated only when specifically authorized by statute." Davis, Administrative Law Treatise (1958), §5.08, p. 341. The mischief caused by according this novel regulation retroactive effect is the wholesale invalidation of arbitration clauses in customer agreements, and the unsettling of established customs and practices that have been recognized as legal for many years.

Arbitration as a method of settling customer controversies has been in widespread use in the industry for many years. It has had the salutary effect of resolving disputes, most of which are technical in nature and require expertise for their resolution, speedily and efficiently, without resort to the complexities of the judicial process. Although there was evidence before the Congress suggesting that contract market grievance settlement procedures were inadequate, there was no evidence that the shortcomings of contract market procedures existed in private arbitration. See statement of District Judge Robinson in *Arkoosh* v.

Dean Witter & Co., 415 F. Supp. 535 at 542 (D. Neb. 1976). The CFTC has not informed the public what the dangers of other than contract market arbitration procedures are. Indeed, the CFTC has taken inconsistent positions on contract market settlement procedures; see Reg. §180.5 which allows contract market settlement procedures for claims in excess of $15,000, so long as they are voluntary, fair and equitable, without compliance with the remaining provisions of the Part 180 regulations. Reg. §180.3 is vulnerable, therefore, not only to the charge that there appears to be no rational basis for the exercise of the CFTC's judgment in applying the new standards of Reg. §180.3 retroactively, but also to the charge that there appears to be no rational basis for its determination to invalidate all arbitration agreements, whenever signed, not complying in form and substance to the rigid requirements of this new and unusual rule. If this regulation is to be given effect at all, it should be on a prospective basis only, to be applied to arbitration agreements signed and to controversies arising on and after its effective date. The prospective application of Reg. §180.3 would have allowed affected persons time to bring their practices and agreements into conformity with the new standards, and would have avoided proscription of past conduct that was legal when undertaken. See *Leedom* v. *Int'l Brotherhood of Electrical Workers*, 278 F.2d at 243.

POINT II

Congressionally and judicially favored arbitration should not be precluded by the doctrine of *Wilko* v. *Swan*.

Defendants have not disputed that plaintiff has a private right of action under the Commodity Exchange Act ("Act"), 7 U.S.C. §1 *et seq.*, although there are no explicit remedies, except the reparations procedure (7 U.S.C. §18), for persons injured by violations of the Act. Plaintiff contends that there is a pervasive public interest in the regulation of the commodity futures markets and the "investor" protection afforded by the Act, and that the alternative of settling disputes arising under the Act by submission to private arbitration is precluded.*

In *Wilko* v. *Swan*, 346 U.S. 427 (1953), a customer brought an action at law against parties in a brokerage firm to recover damages for alleged false representations as to securities. After the commencement of the action at law by the customer in federal district court to recover damages under Section 12(2) (15 U.S.C. §77*l*(2)) of the Securities Act of 1933, the firm tried to stay the trial

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* Persons who deal in the commodity futures market fall into two general classes: hedgers and speculators. Hedging is defined as the establishment of a position in the futures market approximately equal, but opposite, to that held in a cash or physical commodity, in order to shift economic risk to the speculative side of the market. See Reg. §1.3(z), 17 C.F.R. §1.3(z). Definitions of a speculator vary, but a speculator can be defined as a person who assumes risks in expectation of making a profit on price changes. Although plaintiff characterizes the positions he took as "hedge" positions (Complaint, ¶11), he was actually engaged in speculative trading.

of the action under the Federal Arbitration Act (9 U.S.C. §1 *et seq.*) until an arbitration in accordance with an arbitration clause in the margin agreement, consented to by the customer, was held. The limited question, as presented by the Supreme Court in its opinion was:

> "Whether an agreement to arbitrate a future controversy is a 'condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision' of the Securities Act of 1933 which Section 14 (15 U.S.C. §77n) declares void." 346 U.S. at 430.

Mr. Justice Reed, writing for a divided Court, noted that the Securities Act of 1933 was designed to protect investors, and, to that end, requires full and fair disclosure of the character of securities sold in interstate commerce to prevent fraud in their sales. To effectuate this policy, Congress in Section 12(2) (15 U.S.C. §77*l*(2)) created a special right of civil action to recover for misrepresentation which differs substantially from the common law action in that the seller is made to assume the burden of disproving responsibility. To effectuate the purposes of the Securities Act of 1933, Congress conferred concurrent jurisdiction of actions arising thereunder on state and federal courts (15 U.S.C. §77v) and declared conditions, and stipulations, waiving compliance with any of its provisions void (15 U.S.C. §77n).

District Judge Haight concluded that it is the special right of action created by Congress, coupled with the jurisdictional and nonwaiver provisions, that distinguishes the Securities Act of 1933 and, similarly, the Securities Exchange Act of 1934 from the Commodity Exchange Act. The Act is not a disclosure statute requiring the registra-

tion of commodities, futures contracts or options; it is essentially an antifraud statute. Unlike the Securities Act of 1933, Congress did not create a special right of civil action in the Act for traders to recover for wrongdoing. Unlike the Securities Act of 1933, in which concurrent jurisdiction was conferred on federal and state courts, and the Securities Exchange Act of 1934 (15 U.S.C. §78aa) which provides that federal district courts have exclusive jurisdiction, Congress did not bestow jurisdiction on the federal courts for the adjudication of claims arising under the Act within the Act itself. Jurisdiction must be based on either Sec. 1331 or 1337 of Title 28. Unlike the Securities Act of 1933 and the Securities Exchange Act of 1934 (15 U.S.C. §78cc), Congress did not provide a non-waiver clause in the Act.

In *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506 (1974), the Supreme Court indicated that *Wilko,* which was decided only under the Securities Act of 1933, may not apply to alleged violations of the Securities Exchange Act of 1934. 417 U.S. at 513. Among other reasons given, the two statutes have materially different jurisdictional and venue provisions. The seemingly endless enlargement of securities law doctrines appears to have been halted, at least in some directions. See *Piper* v. *Chris-Craft Industries, Inc.,* 97 S.Ct. 926 (1977) (no private remedy under Sec. 14(e) of the Williams Act and Rule 10b-6); *Santa Fe Industries, Inc.* v. *Green,* 97 S. Ct. 1292 (1977) (no 10b-5 cause of action for breach of fiduciary duty in connection with use of Delaware short form merger statute); *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976) (civil damage action based on negligence only not proper under antifraud provisions of the Securities Exchange Act of 1934); *Blue Chip*

Stamps v. *Manor Drug Stores,* 421 U.S. 723 (1975) (much disputed purchaser-seller requirement for a 10b-5 suit affirmed); *United Housing Foundation* v. *Forman,* 421 U.S. 837 (1975) (profit element of "investment contract" test construed rather strictly, so that stock in a non-profit housing cooperative was not a security).

The legislative history of the Act sheds no illumination on the problem. Congress was obviously concerned with contract market grievance settlement procedures, but it did not ban them; rather, Congress required them, establishing the conditions under which they are to be held. 7 U.S.C. §7a(11). It is to be presumed that Congress, in mandating contract markets to provide arbitration facilities for small claims, and in establishing reparations procedures, 7 U.S.C. §18, while not expressing any statutory interest in other kinds of settlement procedures, was implicitly reaffirming its policy favoring arbitration embodied in the Federal Arbitration Act.

The CFTC did not premise the Part 180 regulations on *Wilko* v. *Swan.* On November 24, 1975, the CFTC, responding to comments criticizing the proposed regulations, announced:

> "The Commission received several comments strongly criticizing [the proposed rule prohibiting pre-dispute agreements.] The principal criticisms expressed in those comments were that the Commission had incorrectly relied on an unrelated Supreme Court case, *Wilko* v. *Swan,* 346 U.S. 427 (1953), an action under the federal securities laws. . . . The Commission's action, in the first instance, was not premised on *Wilko* v. *Swan.* * * * * * " 40 F.R. 54430, 54432.

See also 41 F.R. 42942, 42944 (September 29, 1976).

Although there can be similarities between commodities and securities, there is a substantive difference in the expectations of a securities investor and a commodity trader. One of the usual elements of an investment in securities is the expectation of profits from the efforts of other persons on whom the investor relies to operate the enterprise. The commodity trader's expectations depend on an impersonal market for profit or loss; thus, commodities as such are not registered. It is this difference, among others, that distinguishes the Act from the Securities Act of 1933 and the Securities Exchange Act of 1934 and has figured in some interpretations of the securities laws. See, e.g., *Johnson* v. *Merrill Lynch, Pierce, Fenner & Smith Inc.* [Endorsed Order] 76 Civ. 2588 (S.D.N.Y. 1976);* *Stuckey* v. *duPont Glore Forgan Inc.*, 59 F.R.D. 129, 131 (N.D. Cal. 1973); *Berman* v. *Dean Witter & Co.*, 353 F. Supp. 669, 671 (C.D. Cal. 1973); *McCurnin* v. *Kohlmeyer & Co.*, 347 F. Supp. 573, 575-6 (E.D. La. 1972); *Sinva* v. *Merrill Lynch, Pierce, Fenner & Smith Inc.*, 253 F. Supp. 359, 367 (S.D.N.Y. 1966). The Supreme Court in *Wilko* found that it was "reasonable for Congress to put buyers of securities covered by the Act [Securities Act of 1933] on a different basis from other purchasers." 346 U.S. at 435. No such Congressional intent can be found in the Commodity Exchange Act. There is nothing in the scheme of the Act that suggests that Congress intended to change federal policy favoring arbitration and to place commodity traders on any basis different from other persons. If there is any evidence of Congressional intent on the matter, it is to the contrary; the customer's reparations and contract market arbitration procedures indicate that Congress intended to put commodity traders on an equal footing with other persons.

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* See addendum to this brief, p. 9a.

There have been cases in which courts have held that the enforcement of pre-dispute arbitration agreements would not be appropriate. In addition to cases arising under the securities laws, certain other types of cases have been held unsuitable for arbitration pursuant to a pre-dispute agreement: cases arising under the Sherman Act (e.g., *American Safety Equipment Corp.* v. *J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968)), and Title VII of the Civil Rights Act of 1964 (e.g., *Alexander* v. *Gardner Denver Co.*, 415 U.S. 36 (1974)). In each of those cases, the person enforcing an individual right is in reality acting as a private attorney general in the enforcement of a public right and the courts have found that the protection of the public interest is paramount to the protection of the individual. A private right of action for money damages only under the Commodity Exchange Act does not present any special public policy issues that require a judicial determination and necessitate the prohibition of a valid arbitration agreement. In this kind of action, a plaintiff is suing for redress of a private wrong, which is measurable in terms of money damages, and not to vindicate a public right.

Arbitration of the kind sought by defendants in this action should not be precluded by the *Wilko* doctrine, *Milani* v. *Conti Commodities Services Inc.*, CCH Comm. Fut. L. Rptr. ¶20,227 (N.D. Cal. 1976), to the contrary notwithstanding. Even the CFTC has recognized that the *Wilko* doctrine does not apply. 40 F.R. 54430, 54432 (November 24, 1975); 41 F.R. 42942, 42944 (September 29, 1976). Further, the CFTC considers arbitration an efficacious method of settling disputes and affirmatively encourages it. The obligatory language of Reg. § 180.3 begins with the following statement: "While the Com-

modity Futures Trading Commission (CFTC) recognizes the benefits of settling disputes by arbitration, it requires that your consent to such an agreement be voluntary." The statutory basis for *Wilko* does not exist in the Commodity Exchange Act and, absent specific Congressional interest favoring court adjudication of disputes over other settlement procedures, this doctrine should not be applied as a bar to arbitration.

CONCLUSION

This Court should affirm the order of the District Court staying the trial of this action and compelling arbitration. *Johnson* v. *Merrill Lynch, Pierce, Fenner & Smith Inc., supra; Arkoosh* v. *Dean Witter & Co. Inc., supra.*

Respectfully submitted,

JAMES J. DOLAN
Attorney for Defendants-Appellees

July 25, 1977

ADDENDUM

17 C.F.R. Part 180—Arbitration or Other Dispute Settlement Procedures

Reg. § 180.1. DEFINITIONS.

(a) The term "claim or grievance" as used in this Part shall mean any dispute which arises out of any transaction on or subject to the rules of a contract market executed by or effected through, a member of that contract market or employee thereof which dispute does not require for adjudication the presence of essential witnesses or third parties over whom the contract market does not have jurisdiction and who are not otherwise available. The term claim or grievance does not include disputes arising from cash market transactions which are not a part of, or directly connected with, any transaction for the purchase or sale of any commodity for future delivery.

(b) The terms "customer" and "customers" as used in this Part do not include members of the contract market where the claim or grievance arose.

Reg. § 180.2. FAIR AND EQUITABLE PROCEDURE.

Within ninety days of the effective date of this Part, every contract market shall adopt rules which provide for a fair and equitable procedure through arbitration or otherwise for the settlement of customers' claims and grievances not in excess of $15,000 against any member or employee thereof which shall include at least the following as minimum requirements for a fair and equitable procedure:

(a) The procedure shall be objective and impartial. Customers must be provided with the choice of a panel or other

decision-making body having at least a majority of the persons serving thereon who are not members or associated with any member of the contract market, or employee thereof, and who are not otherwise associated with the contract market. The rules of a contract market may, with proper notice, require the customer to request such a panel or other such decision-making body at the time of submission of the claim or grievance to the procedure, and, if such an election is made, to notify the customer at such time that the panel or other such decision-making body may, in its discretion, assess the losing party with any increased costs, or otherwise allocate any incurred costs, if any, attendant to having such a panel or decision-making body. Ex parte contacts by any of the parties with members of any panel shall not be permitted.

(b) The procedure shall grant each of the parties the right, if desired, to be represented by counsel, at his own expense, in any aspect of the procedure.

(c) The procedure shall provide for the prompt settlement of claims or grievances and counterclaims, if any (permitted by § 180.4 of this Part). Unnecessary or unreasonable delay by any of the parties shall not be permitted.

(d) The procedure shall require adequate notice to the parties and opportunity for a prompt hearing as follows:

(1) Each of the parties shall be entitled personally to appear at such hearing, unless the contract market shall have adopted a procedure for the written submission of claims or grievances (and any counterclaims applicable thereto) which are in the aggregate under $2,500. If the claim or grievance (and any counterclaim applicable thereto) is in the aggregate under $2,500, then provision may be

made for the claim or grievance of a customer to be resolved without a hearing through a submission on the basis of written documents.

(2) The formal rules of evidence need not apply at the hearing. Nevertheless, the procedure established may not be so informal as to deny due process. Each party must be given adequate opportunity to prepare and present all relevants facts in support of the claims and grievances, defenses, or counterclaims (permitted by § 180.4 of this Part), and to present rebuttal evidence to such claims or grievances, defenses or counterclaims made by the other parties.

(3) Each party shall be entitled to examine other parties and any witnesses appearing at the hearing and to examine all relevant documents presented in connection with a claim or grievance, defense or a counterclaim applicable thereto.

(4) A verbatim record of the hearing may be required, the cost of which must be reasonable. There shall be no requirement that a verbatim record be transcribed unless requested by a party who shall bear the cost of the transcription, and contract markets shall otherwise seek to minimize the cost associated with such record.

(e) The procedure shall provide adequate notice to the parties in advance of a submission of a claim or grievance, or counterclaim (permitted by § 180.4 of this Part), of the nature and amount of any fees or costs which may be assessed against customers utilizing the procedure. Fees or costs shall be reasonable, particularly in relation to the complexity and amount of the claim or grievance or counterclaim, if any, presented. Costs may be apportioned among the parties or may be assessed against the losing party as the panel or other decision-making body, in its discretion, sees fit.

(f) The procedure shall provide that the settlement award shall be rendered promptly in writing and be final. There shall be no right of appeal to any entity within the contract market which can overturn the settlement procedure decision; the only right of appeal being as provided under applicable law.

(g) The procedure shall not impose any restrictions on the jurisdiction or venue of any court to enforce an award so rendered.

Reg. § 180.3. VOLUNTARY PROCEDURE AND COMPULSORY PAYMENTS.

(a) The use by customers of the dispute settlement procedures established by contract markets pursuant to the Act or this Part or of the arbitration or other dispute settlement procedures specified in an agreement under paragraph (b)(3) of this section shall be voluntary. The procedures so established shall prohibit any agreement or understanding pursuant to which customers of members of the contract market agree to submit claims or grievances for settlement under said procedures prior to the time when the claim or grievance arose, except in accordance with paragraph (b) of this section.

(b) No futures commission merchant, floor broker or associated person shall enter into any agreement or understanding with a customer in which the customer agrees, prior to the time the claim or grievance arises, to submit such claim or grievance to any settlement procedure except as follows:

(1) Signing the agreement must not be made a condition for the customer to utilize the services offered by

the futures commission merchant, floor broker or associated person;

(2) If the agreement is contained as a clause or clauses of a broader agreement, the customer must separately endorse the clause or clauses containing the cautionary language and other provisions specified in this section;

(3) The agreement may not require the customer to waive the right to seek reparations under Section 14 of the Act and Part 12 of these regulations. Accordingly, the customer must be advised in writing that he or she may seek reparations under Section 14 of the Act by an election made within 45 days after the futures commission merchant, floor broker or associated person notifies the customer that arbitration will be demanded under the agreement. This notice must be given at the time when the futures commission merchant, floor broker or associated person notifies the customer of an intention to arbitrate. The customer must also be advised that if he or she seeks reparations under section 14 of the Act and the Commission declines to institute reparation proceedings, the claim or grievance will be subject to the preexisting arbitration agreement and must also be advised that aspects of the claims or grievances that are not subject to the reparations procedure (*i.e.* do not constitute a violation of the Act or rules thereunder) may be required to be submitted to the arbitration or other dispute settlement procedure set forth in the preexisting arbitration agreement.

(4) The customer agreement must contain cautionary language, printed in large boldface type, to the following effect:

WHILE THE COMMODITY FUTURES TRADING COMMISSION (CFTC) RECOGNIZES THE

BENEFITS OF SETTLING DISPUTES BY ARBITRATION, IT REQUIRES THAT YOUR CONSENT TO SUCH AN AGREEMENT BE VOLUNTARY. YOU NEED NOT SIGN THIS AGREEMENT TO OPEN AN ACCOUNT WITH [name]. See 17 CFR 180.1-180.6.

BY SIGNING THIS AGREEMENT, YOU MAY BE WAIVING YOUR RIGHT TO SUE IN A COURT OF LAW, BUT YOU ARE NOT WAIVING YOUR RIGHT TO ELECT AT A LATER DATE TO PROCEED PURSUANT TO SECTION 14 OF THE COMMODITY EXCHANGE ACT TO SEEK DAMAGES SUSTAINED AS A RESULT OF A VIOLATION OF THE ACT. IN THE EVENT A DISPUTE ARISES, YOU WILL BE NOTIFIED IF [name] INTENDS TO SUBMIT THE DISPUTE TO ARBITRATION. IF YOU BELIEVE A VIOLATION OF THE COMMODITY EXCHANGE ACT IS INVOLVED AND IF YOU PREFER TO REQUEST A SECTION 14 "REPARATIONS" PROCEEDING BEFORE THE CFTC, YOU WILL STILL HAVE 45 DAYS IN WHICH TO MAKE THAT ELECTION.

(5) If the agreement specifies a forum for settlement other than a procedure established pursuant to section 5a(11) of the Act or this Part, the procedures of such forum must comply with the requirements of § 180.5 of this Part.

(c) The procedure established by a contract market pursuant to section 5a(11) of the Act or this Part may require parties utilizing such procedure to agree, under applicable state law, submission agreement or otherwise, to be bound by an award rendered in the procedure, provided that the agreement to submit the claim or grievance to the procedure was made in accordance with paragraph (b) of this section

or the agreement to submit the claim or grievance to the procedure was made after the claim or grievance arose. Any award so rendered shall be enforceable in accordance with applicable law.

(d) The procedure established by a contract market pursuant to the Act or this Part shall not establish any unreasonably short limitation period foreclosing submission of customers' claim or grievances or counterclaims (permitted by § 180.4 of this Part) by contract market members or employees thereof.

Reg. § 180.4. COUNTERCLAIMS.

A procedure established by a contract market under the Act for the settlement of customers' claims or grievances against a member or employee thereof may permit the submission of a counterclaim in the procedure by a person against whom a claim or grievance is brought. The contract market may permit such a counterclaim where the counterclaim arises out of the transaction or occurrence that is the subject of the customer's claim or grievance and does not require for adjudication the presence of essential witnesses, parties or third persons over whom the contract market does not have jurisdiction. Such a counterclaim may not be for an amount in excess of $15,000. Other counterclaims are permissible only if the customer agrees to the submission after the counterclaim has arisen, and if the aggregate monetary value of the counterclaim is capable of calculation and is not in excess of $15,000.

Reg. § 180.5. OTHER CUSTOMER CLAIMS AND GRIEVANCES OR DISPUTES.

A contract market may establish a procedure for settlement of customers' claims and grievances or disputes against any member or employee thereof, which are not covered by §§ 180.1 through 180.4 of this Part. The procedure shall be independent of, and shall not interfere with or delay the resolution of, customers' claims or grievances submitted for resolution under the contract market procedure established pursuant to the Act. The procedure must be shown to be voluntary, and must be fair and equitable as defined by § 180.2 and § 180.3 of this Part except that the aggregate monetary value of the claim or grievance or counterclaim, if any, may exceed $15,000.

Reg. § 180.6. MEMBER-TO-MEMBER SETTLEMENT PROCEDURES.

A contract market may establish a procedure for compulsory settlement of claims and grievances or disputes which do not involve customers. If adopted, the procedure shall be independent of, and shall not interfere with or delay the resolution of, customers' claims or grievances submitted for resolution under the procedure established pursuant to the Act. Such a procedure shall provide procedural safeguards which must include, at a minimum, fair and equitable procedures conforming to those set forth in § 180.2 of this Part, except that the election of the mixed panel contained in § 180.2(a) of this Part need not be required.

Johnson v. *Merrill Lynch, Pierce, Fenner & Smith Inc.*,
[Endorsed Order] 76 Civ. 2588 (Judge Weinfeld)
(S.D.N.Y. 1976)

"The motion to stay proccedings in this case pending arbitration is granted. Plaintiff cannot avoid compliance with the arbitration clause to which he consented by claiming the protection afforded by the "non-waiver of rights" provision of the Securities Exchange Act of 1934, 15 U.S.C. § 78cc(a). Plaintiff's claims, based on his purchases and sales of commodity futures contracts, do not arise "in connection with the purchase or sale of any security," 15 U.S.C. § 78j(b); *see* Johnson v. Arthur Espey, Shearson, Hammill & Co., 341 F. Supp. 764 (S.D.N.Y. 1972); Berman v. Orimex Trading Co., 291 F. Supp. 701, 702 (S.D.N.Y. 1968); Maheu v. Reynolds & Co., 282 F. Supp. 423, 426 (S.D.N.Y. 1968); Sinva, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 253 F. Supp. 359, 366 (S.D.N.Y. 1966), and thus neither the Exchange Act nor the case of *Wilko* v. *Swan*, 346 U.S. 427 (1953), is applicable to those claims. Moreover, the instant case is readily distinguishable from *Newman* v. *Shearson, Hammill & Co.*, 383 F. Supp. 265 (W.D. Tex. 1974), for in that case the plaintiff did not specifically agree to arbitration, but rather agreed to be bound by the rules of the New York Stock Exchange, which do not compel non-members to arbitrate disputes."

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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HAROLD AMES,

Plaintiff-Appellant,

-against-

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC. and CHRISTOPHER V. STREIT,

Defendants-Appellees.

----------x

Docket No. 77-7192

PROOF OF SERVICE

STATE OF NEW YORK

COUNTY OF NEW YORK

Rosa Maria Woodard, being duly sworn, depo[illegible] and says:

I am not a party to this action and I am over the age of 18 years. My office is at 165 Broadway - 31st Floo[illegible], New York, New York 10006. On July 25, 1977 I served two copies of the Appellees' Brief by mail upon Lowenthal, Landau, Fischer & Singer, 250 Park Avenue, New York, New York 10017.

Rosa Maria Woodard
Rosa Maria Woodard

Subscribed and sworn to
this 25th day of July, 1977.

James J. Dolan

JAMES J. DOLAN
Notary Public, State of New York
No. 30-0980475 Qual. in Nassau Co.
Commission Expires March 30, 1979